**Docket No:** 98-0252,
98-0335 and 00-0764
Consolidated
**Bench Date:** 2/11/03
**Deadline:** 2/18/03

**MEMORANDUM**

**TO:** The Commission

**FROM:** Eve Moran and Phillip A. Casey,
Administrative Law Judges
Assisted by Arshia Javaherian, Legal Extern

**DATE:** February 7, 2003

**SUBJECT:** Illinois Bell Telephone Company

Application for review of alternative regulation plan.

Illinois Bell Telephone Company

Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates.

Citizens Utility Board and The People of the State of Illinois
-vs-
Illinois Bell Telephone Company

Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief.

**RECOMMENDATION:** Grant Rehearing in Part.

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## INTRODUCTION

The Illinois Commerce Commission entered its Final Order in the above-captioned matter on December 30, 2002. On January 29, 2003, there was filed the Application for Rehearing of SBC Illinois ("Application") with respect to that very order. This Application is the matter of concern at hand.

Section 200.880 of Part 83 of the Illinois Administrative Code provides:

a) After issuance of an order on the merits by the Commission, a party may file an application for rehearing. The application shall state the reasons therefore and shall contain a brief statement of proposed additional evidence, if any, and an explanation why such evidence was not previously adduced. The application shall be filed within 30 days after service of the order on the party.

d) No appeal shall be allowed from any order or decision of the Commission unless and until an application for rehearing thereof shall first have been filed and finally disposed of by the Commission. The Commission shall grant or deny the application in whole or in part within 20 days from the date of receipt by the Commission. 83 Ill.Adm. Code 200.880 (a)(d).

The deadline for Commission action on the instant SBC-Illinois rehearing application, is February 18, 2003.

## THE APPLICATION FOR REHEARING/ISSUES

While the Order is both long and complicated, SBC-Illinois' filing suggests only five errors. Here is a review of the issues and arguments raised in support of rehearing, along with the Administrative Law Judges' recommendations:

### I. The Capital Spending Requirement.

SBC-Illinois (or the "Company") takes issue with a portion of the order's concluding section, i.e., Part VIII, wherein it adopts a capital spending requirement that extends a certain merger condition ( Merger Condition 7, that had required SBC-Illinois to invest $3 billion in its network infrastructure ), by now adding an additional obligation to spend $1.2 billion in 2006 and 2007, and $600 million each year thereafter, until an order continuing or terminating the plan is adopted. Order at 211-12.[1] This requirement, SBC-Illinois contends, is clearly unlawful (barred by the legal doctrine of estoppel and contrary to section 7-240 (f) of the PUA) and further, is not supported in any way by the evidence of record.

In addition, the Company argues, the requirement is structured in such a way as to deviate from prior Commission action but without the requisite explanation for the change. Even if the Commission were to impose an investment obligation on SBC Illinois (which it cannot and should not do), the Company contends that, at a minimum, it should be structured consistent with the 1994 Alt Reg Order and the Merger Order and provide the necessary flexibility in spending.

[1] SBC-Illinois points out that the five-year term of Merger Condition 7 actually runs from 2000 through 2004, not through 2005 (which would be a sixth year). Compare Order at 211-12 with Merger Order at 240. This error in the Order does not affect SBC Illinois' position.

So too, SBC-Illinois contends, the Order provides no legitimate policy reasons for this investment obligation – either inside or outside the record. According to SBC-Illinois, such arbitrarily-derived spending obligations (with no record to show that $1.2 billion over 2006 and 2007 is the "right" level of investment, or that $600 million would be the "right" level of investment in any subsequent year) can prove to be counter-productive on several fronts (e.g. interfere with business decisions) and harm the very ratepayers the Commission is trying to protect.

To be sure, the section of the Order being challenged here did not appear in the HEPO/PEPO and, as such, was not addressed by any of the parties. Therefore, none of the legal points and factual matters raised by the Company were ever explored, analyzed or discussed.

It may take a better examination of the record to legally sustain that portion of the Order here in question. In our view, SBC-Illinois has raised legitimate arguments to be considered and resolved on rehearing.

The ALJs recommend that the Commission grant rehearing on this issue.

## II. The Retail Service Quality Penalties.

SBC- Illinois raises the issue of excessive penalties evolving from the Order with respect to two (2) specific performance measures. According to the Company, the Order increases the service quality penalties for (1) the repair measure (Out of Service Over 24 Hours or "OOS>24") and (2) the installation measure (Installation Within Five Business Days) *eightfold*.

SBC-Illinois points out that whereas the original 1994 Alt Reg Order established a Q factor adjustment of 0.25 per missed measure annually (which equates to a $2.65 million permanent rate reduction), action taken in the instant Order increases the adjustment to 2.00 for repair and installation (which equates to a *$21 million permanent rate reduction* for any year that the measure is missed).

Further, this penalty is imposed on top of a *$30 million penalty* for OOS>24 that was adopted in the Commission's Order approving the SBC/Ameritech merger. Merger Order at 200.

Further still, these penalties are in addition to the other customer credits and penalties imposed by Section 13-712 of the Act and the Commission's Part 730 and Part 732 service quality rules. 220 ILCS 5/13-712; 83 Ill. Admin. Code Parts 730, 732. As such and on the whole, SBC-Illinois argues, the increases in the Q factor are excessive and punitive.

These penalties, the Company maintains, dwarf, by *many* orders of magnitude, any penalties automatically assessed on other carriers in Illinois that experience service

quality problems.[2] The punitive nature of this penalty structure, SBC-Illinois points out, is further exacerbated by the fact that it is triggered by even the slightest error on SBC Illinois' part.

For example, under the repair standard, SBC- Illinois must restore 95 percent of all out-of-service conditions within 24 hours. If the Company's performance in a given year is 94.99 percent, instead of 95 percent, the entire $51 million rate reduction would be required.

Similarly, with respect to the installation standard and where 90 percent of service orders must be completed within five business days, if SBC Illinois were to only complete 89.99 percent of these orders within five business days, instead of 90 percent, the entire $21 million rate reduction would be imposed on the Company. To impose such draconian penalties in utter disregard for the minor extent of the infraction, the Company asserts, is arbitrary and capricious. This is especially the case, SBC-Illinois argues, given that the Company's service is now, and has been for two years, excellent.

There is no continuing pattern of conduct on record, the Company maintains, to justify these penalty levels. SBC Illinois contends that it brought its installation and repair performance to its current high level under both the *existing* Plan structure and the $30 million repair penalty prescribed in the Merger Order. Given that these penalties were shown sufficient to provide the proper incentives to the Company to correct any existing service quality problems, SBC-Illinois asserts that there is no rational basis for increasing the Plan's penalties at all - much less *eightfold*.

The Order's escalation of the Q factor adjustments, the Company maintains, also ignores recent changes in the Commission's authority to ensure adequate service quality under Section 13-712 of the Act and the Commission's Part 730 and Part 732 service quality rules.

Today, Section 13-712 of the Act and Part 732 of the Commission's rules provide for direct compensation of consumers for installation or repair delays or for missed appointments. 220 ILCS 5/13-712; 83 Ill. Admin. Code Part 732. Moreover, if SBC Illinois (or any other carrier) violates the Commission's Part 730 or Part 732 rules, Sections 13-303, 13-304 and 13-305 of the Public Utilities Act, all of which were adopted in the 2001 amendments to the Act, permit the Commission to levy civil penalties and, if necessary, to seek injunctions or writs of mandamus. See 220 ILCS 5/13-303, 13-304, 13-305 (effective June 30, 2001).

To be sure, SBC-Illinois asserts, all of the statutory changes have decreased the need for substantial service quality penalties in the Plan and must be considered in the

[2] SBC Illinois is the only carrier operating under an Alternative Regulation Plan. Other carriers in the state are only subject to the Commission's Part 732 Rules, which require customer compensation for missed installation, repair and appointment obligations. Although the Commission may assess civil penalties for violations of its service rules, such penalties are not automatic and must be preceded by notice and hearing. Moreover, the penalties would be in the form of a one-time payment – not permanent rate reductions that cannot be reversed in subsequent years.

decision making process. The Order, SBC-Illinois points out, does *not* account for the cumulative impact of these legislative-driven changes and, therefore, is arbitrary and capricious. On all these counts, the Company asserts, the service quality penalty structure imposed in this Order for the measures discussed, needs to be changed.

The ALJs would remind the Commission that the Order adopts a penalty scheme wholly different from the HEPO or PEPO. This means that all parties were left unable to address the matter at hand in their exceptions arguments.

The ALJs firmly believe and have always maintained that the whole of the statutory scheme set out by the General Assembly must be considered in setting out an appropriate penalty scheme. Thus, it is important to examine not only Section 13-506.1 (which directly implicates the SBC-Illinois Plan) but also the newly enacted provisions such as 13-712 that do not exclude the Company and address matters that overlap the Plan. The Order recognizes this in one part and for one purpose (rejecting direct compensation proposals for the Plan because of Section 13-712). The Order, however, wholly and inconsistently, omits such analysis in another part (failing to reconcile the direct compensation to be paid out under Section 13-712 with Plan penalties for the same exact measures).

Staff's proposal, on which the Order largely rests, did not take account of the new law, i.e., Section 13-712. It also did not consider or analyze the severity of the penalty mechanism in the instance of a minor infraction. The severity of the violation, however, is a concept that the Governmental and Consumer Intervenors well recognized (Order at 171) and this should be factored into the Commission's analysis. In its current state, the Order does not consider (either accept or reject) a gradual escalation in penalties to correspond with the severity of the situation, or take account of other remedies. Based solely on the arguments at hand, there also appears to be a fatal mismatch with respect to a penalty proven to be an effective incentive and what the Order would impose.

Even on a cursory review, it appears that the penalties put at issue are set out without any studied analysis of the end result, or the effect of all relevant and impinging legal and factual considerations, or any assessment of the suitability for meeting the main objective. Under the circumstances, rehearing is both warranted and strongly recommended.

The ALJs recommend that rehearing on the instant issue be granted.

## III. Incorporation of the Wholesale Remedy Plan.

SBC- Illinois also seeks rehearing of the Order's decision to incorporate here the wholesale performance remedy plan that was established pursuant to Condition 30 of the Commission's Order approving the SBC/Ameritech merger and modified by the Commission in Docket 01-0120. (Order at 190). SBC Illinois agrees with the Order's conclusion that the Docket 01-0120 plan should not be extended for the life of the

alternative regulation plan, and appreciates the opportunity to present an alternative plan for the Commission's consideration in Docket 01-0662. Nevertheless, in Docket 01-0120, SBC Illinois demonstrated (1) that it would be improper to extend the life of the remedy plan beyond the October 8, 2002 expiration date of the underlying merger condition, and (2) that some of the substantive features of the plan unfairly and excessively penalize SBC Illinois, and fail to recognize SBC Illinois' improvements in wholesale processes and performance. SBC Illinois recognizes that the Commission held otherwise, and those issues are now before the Appellate Court. Because the Order here attempts to transplant the plan from Docket 01-0120 into the instant Alt Reg Plan, SBC Illinois respectfully renews those objections and details plentiful arguments in support of its rehearing request.

The Order language at issue, however, was not drafted by, or discussed with the ALJs at any session prior to its adoption by the Commission. As such, we tender no recommendation on this issue.

## IV. Basket Structure.

The Commission adopted the language as provided in the ALJs' Post Exception Proposed Order. SBC Illinois reiterates its prior position.

It is the ALJs' recommendation that re-hearing on this issued be denied.

## V. Reinitialization of the API/PCI.

The Commission rejected the conclusion of the ALJs and elected to reinitialize the API/PCI on a going forward basis. API is the Actual Price Index. PCI is the Price Cap Index. How these indexes are determined can be found on pages 86-88 of the Order.

As provided for in the original Alternative Regulation Order, the Commission set both the API and PCI equal to 100 (Order at Appendix A.), Section 2(a). Staff and City/GCI recommend that these indices, which have declined over time, be reset to 100 on a going forward basis. It was Staff's position that reinitialization will have the effect of affording the Plan the maximum capacity to affect rate changes. Staff allows that reinitialization will primarily affect the Carrier Basket.

Without reinitialization, customers purchasing services from the Carrier basket, such as switched access services, would not benefit from efficiency gains experienced by AI in the future. This is because the API for the Carrier Basket is already below the PCI. City/GCI also agree with Staff that reinitializing the API and PCI to 100, would give the Plan the maximum potential to affect rates.

SBC-Illinois opposed the reinitialization of the API/PCI indices. By reinitializing, the Company argued, "headroom" is effectively eliminated. Headroom occurs when

rates in particular baskets decline more than the index would have required. Reinitializing the API/PCI combined with subjecting carrier access rates to the price index, would, SBC-Illinois contended, require further decreases to carrier access rates in the annual price cap filing. SBC-Illinois concludes, this result is inconsistent with the Commission's Order in Docket 97-0601/602.

It is the Company's position that there is little likelihood it could offset the headroom associated with carrier access rate decreases with increases in other carrier rates. SBC-Illinois noted that other services within the Carrier basket are incapable of being increased as they would require another TELRIC/wholesale (resale) pricing proceeding.

The ALJs concluded that the API/PCIs in the existing Plan should not be reinitialized on a going forward basis. Reinitialization will effectively eliminate the headroom that has been achieved by the Company during the initial term of the Plan. Reinitialization of the baskets would serve as a disincentive to the Company to operate efficiently in the future.

It is the ALJs' recommendation that re-hearing on the issue of reinitialization of API/PCI be granted.

**SUMMARY.**

Based on our review, the ALJs recommend that the Commission grant rehearing on three of the issues set out in the SBC-Illinois Application, deny rehearing on one of the issues, and render no recommendation on the remaining issue.

EM/PAC:jt